COCHRANE-DUNLOP LIMITED ANNUAL REPORT 1977

COCHRANE-DUNLOP LIMITED

HIGHLIGHTS

	1977	*1976*
Sales	$71,763,621	*$67,089,440*
Net income for the year	$ 952,398	*$ 928,220*
Net income per share	$1.03	*$1.00*
Total assets	$28,434,095	*$25,414,930*
Working capital	$ 9,651,321	*$ 9,053,904*
Shareholders' equity		
—total	$14,010,406	*$13,363,745*
—per share	$15.12	*$14.42*

REPORT OF THE DIRECTORS TO THE SHAREHOLDERS

When the Corporation's 1976 report was presented to shareholders, positive government inducements, aimed at reinstating industrial incentives, gave promise of an improved outlook for our services. This, combined with the potential benefits of our new branch in Alberta and other improvement programs, indicated that the general forecast was favourable.

While many of our expectations were fulfilled in 1977, it is apparent that the economic stimulus promised in 1976 and early 1977 did not have the immediate effect on the general economy that was anticipated. Growth in domestic consumption was slow and a decline in competitiveness in the world market for many of our major industries has influenced overall production levels. Unutilized capacity and high unemployment have lead to a lack of confidence and a restriction on new investment. Conservative budgeting by governments at most levels, in an attempt to control ever-increasing deficits, has had a parallel impact on general industrial expenditure.

The Corporation's results for 1977 have, in the face of these uncertainties, been generally satisfactory. The new development in Alberta can, it is expected, achieve a solid base sooner than originally anticipated. As a major investment of capital in inventory is essential to a distribution function, the partial recognition by the Federal government of the impact of taxes on inflation-based profits has benefited your Corporation significantly and control on expenses and costs through anti-inflation programs has had a smoothing effect on the precipitous inflation growth of previous years.

The financial statements of Cochrane-Dunlop Limited for the year ended December 31, 1977, which include the operations of all subsidiary companies, and the report of the auditors thereon, are submitted on behalf of your Board of Directors.

Sales

Sales for the 1977 year at $71.8 million were 7% over sales in 1976. Sales by branches which primarily serve customers in the natural and basic resource fields showed good growth in the year. Branches catering to a consumer market base or having a broad interest in secondary manufacturing, experienced the effect of the lack of consumer confidence and constraints on new investment which were widespread in the general economy. Sales of the new industrial supply branch in Calgary, Alberta, far exceeded first year planned levels. Achievement of a good volume in the first operating year should provide this branch with a firm foundation for progress in the future.

Earnings

Consolidated net income for the year was $952,000 or $1.03 per share, compared with $928,000 or $1.00 per share, in 1976.

The general circumstances affecting sales volume have been referred to. Gross margins have been held close to 1976 levels, and below those permitted under Anti-Inflation Legislation. Expenses have shown an increasing trend. This reflects not only inflation originated price and cost adjustments, but also, it is important to appreciate, 1977 expenses include the start up costs and essentially a full year's operating expenses for the major branch in Calgary, Alberta. As mentioned previously, sales from this branch have developed more rapidly than planned, however, costs of initial inventory acquisition, stocking, initial development of the branch organization and other preliminary costs representing the normal development costs of a new outlet are not expected to be recovered in the first year of operation. In addition, the total costs of land, building, equipment, inventory and working capital for the Calgary branch have been financed through current bank credit arrangements. A major portion of building costs were incurred late in 1976 and the balance during 1977. This factor, when combined with an increase in financing to accommodate regular growth and inflation increases in all other locations, has resulted, in 1977, in a significant increase in the cost of interest on bank indebtedness.

Depreciation charges in 1977 reflect the full impact of annual depreciation related to the Calgary facility bringing this element of expense to the highest level ever recorded by the Corporation.

Continuation of inflation at current rates, particularly for an organization in the business of warehousing and distribution, and having as a result the largest part of its investment in current assets (accounts receivable and inventories), is of serious concern. In partial recognition that this problem is increased by the imposition of income taxes on inflation-based profits, an inventory allowance of 3% of opening inventory value was introduced into income tax legislation in 1977, to be applied against accounting income. The net effect of this allowance on income taxes in 1977 and the resulting increase in net income for the year is approximately $180,000.

Fixed Assets

While the major costs of construction of the Calgary branch were incurred in 1976, the costs of equipment, shelving, office equipment, material handling equipment, spur line, etc., required to complete this outlet constitute a major portion of fixed asset expenditures in 1977. Other expenditures include refixturing a wholly-owned retail store in Hamilton, Ontario, leasehold improvement costs incurred in connection with the move of the Corporation's Head Office in Toronto, improvements in material handling equipment and general equipment replacement and upgrading.

Dividends

Regular quarterly dividends of 5¢ per share and a special year-end extra dividend of 13¢ per share, payable on January 31, 1978, were declared in 1977. These dividends were paid on a "tax deferred" basis out of the Corporation's 1971 capital surplus on hand. These payments fall within the limits prescribed under the Anti-inflation program.

Changes in income tax legislation in 1977 will effectively eliminate the concept of "tax deferred" dividend payments after December 31, 1978 by ending the special treatment afforded distribution of surpluses accumulated prior to 1972. In order to best utilize distribution techniques available in 1978 but not thereafter, an extraordinary special dividend of $1.80 per share was declared and paid in January, 1978 out of 1971 Capital Surplus on Hand. This "tax deferred" dividend utilized essentially all of this type of surplus which is available for distribution. To facilitate distributions within the time limits established, the Anti-Inflation Board has allowed dividend payments in excess of the Guidelines to the extent necessary. This payment has been financed through the Corporation's regular current bank credit arrangements.

Outlook

While indications of weakness in specific economic matters (inflation, the relative value of the Canadian dollar, consumer confidence) give concern for the short term, the positive factors in the economy, while receiving all too little publicity, should not be overlooked.

Employment is at a high level; recent changes in currency exchange rates will encourage Canadian production and secondary industry; natural and basic resource industries and their support activities are receiving increased attention and most governmental authorities appear to be attempting to stimulate the economy in a responsible manner and at the same time to bring deficits under control.

In view of this environment we are of the opinion that your company can develop the necessary new initiatives to show a satisfactory result for the coming year.

On behalf of the Board
April 18, 1978

F. Cochrane
President

COCHRANE-DUNLOP LIMITED

CONSOLIDATED STATEMENT OF INCOME

FOR THE YEAR ENDED DECEMBER 31, 1977

	1977	1976
Sales	$71,763,621	*$67,089,440*
Costs and expenses, exclusive of the following items	68,803,346	*64,130,273*
Depreciation	399,283	*333,433*
Remuneration of directors and senior officers	275,500	*270,500*
Interest on bank indebtedness	773,094	*547,014*
	70,251,223	*65,281,220*
Income before income taxes	1,512,398	*1,808,220*
Income taxes (note 3)	560,000	*880,000*
Net income for the year	$ 952,398	*$ 928,220*
Net income per share for the year	$1.03	*$1.00*

CONSOLIDATED STATEMENT OF RETAINED EARNINGS

FOR THE YEAR ENDED DECEMBER 31, 1977

	1977	1976
Balance, beginning of year	$12,830,045	*$12,261,562*
Net income for the year	952,398	*928,220*
	13,782,443	*13,189,782*
Deduct:		
Dividends	305,737	*305,737*
Tax paid on undistributed income	—	*54,000*
	305,737	*359,737*
Balance, end of year	$13,476,706	*$12,830,045*

(See accompanying notes)

COCHRANE-DUNLOP LIMITED

CONSOLIDATED BALANCE SHEET

DECEMBER 31, 1977

ASSETS

	1977	*1976*
Current assets:		
Cash	$ 10,307	*$ 11,587*
Accounts receivable	8,400,911	*7,963,891*
Merchandise inventory	14,855,888	*12,521,110*
Prepaid expenses and other assets	807,904	*608,501*
	24,075,010	*21,105,089*
Fixed assets, at cost:		
Buildings and equipment	5,501,653	*5,343,447*
Furniture and fixtures	2,152,684	*1,949,308*
Automotive equipment	349,214	*297,172*
	8,003,551	*7,589,927*
Less accumulated depreciation	4,715,061	*4,332,629*
	3,288,490	*3,257,298*
Land	1,070,595	*1,052,543*
	4,359,085	*4,309,841*
	$28,434,095	*$25,414,930*

LIABILITIES AND SHAREHOLDERS' EQUITY

	1977	*1976*
Current liabilities:		
Bank indebtedness	$ 8,852,441	*$ 6,397,883*
Accounts payable and accrued charges	4,924,234	*4,897,432*
Income and other taxes payable	480,248	*589,104*
Dividends payable	166,766	*166,766*
	14,423,689	*12,051,185*
Shareholders' equity:		
Share capital (note 2)	533,700	*533,700*
Retained earnings	13,476,706	*12,830,045*
	14,010,406	*13,363,745*
	$28,434,095	*$25,414,930*

On behalf of the Board:
F. COCHRANE, *Director*
F. S. MARTIN, *Director*

(See accompanying notes)

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

FOR THE YEAR ENDED DECEMBER 31, 1977

	1977	*1976*
Funds were obtained from:		
Net income for the year	$ 952,398	*$ 928,220*
Depreciation, an item not requiring a current outlay of funds	399,283	*333,433*
	1,351,681	*1,261,653*
Funds were applied to:		
Expenditures on fixed assets	448,527	*1,671,273*
Dividends	305,737	*305,737*
Tax paid on undistributed income	—	*54,000*
	754,264	*2,031,010*
Increase (decrease) in working capital	597,417	*(769,357)*
Working capital, beginning of year	9,053,904	*9,823,261*
Working capital, end of year	$ 9,651,321	*$ 9,053,904*

(See accompanying notes)

AUDITORS' REPORT

To the Shareholders of
Cochrane-Dunlop Limited:

We have examined the consolidated balance sheet of Cochrane-Dunlop Limited as at December 31, 1977 and the consolidated statements of income, retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of Cochrane-Dunlop Limited as at December 31, 1977 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Toronto, Canada,
March 31, 1978.

CLARKSON, GORDON & CO.
Chartered Accountants

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 1977

1. Summary of significant accounting policies

(a) Basis of consolidation—

The consolidated financial statements include the accounts of the Corporation and all of its subsidiaries and include the earnings of the subsidiaries since acquisition.

(b) Inventories—

Inventories are valued at the lower of cost, determined on a first-in first-out basis, and net realizable value.

(c) Depreciation—

The Corporation and its subsidiaries provide for depreciation on fixed assets on the reducing balance method. The rates of depreciation are:

	Rate
Buildings and equipment	5% and 10%
Furniture and fixtures	20%
Automotive equipment	30%

2. Share Capital

The authorized capital of the Corporation consists of 1,500,000 common shares without par value of which 926,476 common shares are issued as fully paid and non-assessable.

3. Income Taxes

Effective in 1977, Canadian income tax legislation was amended to introduce a deductible inventory allowance equal to 3% of opening inventory value. The effect of this allowance has been reflected in the consolidated statement of income in 1977, increasing net income for the year by approximately $180,000.

4. Lease commitments

The Corporation is committed to annual rental payments of approximately $314,000 on leases expiring in the years 1977 to 1989.

5. Anti-inflation legislation

The Corporation is subject to mandatory compliance with the controls on prices, profit margins and employee compensation imposed by the Anti-Inflation Act which became effective from October 14, 1975 and are presently scheduled to be applicable to the Corporation until December 31, 1978.

The Act also restricts ordinary dividends to the Corporation's shareholders during the year ending October 13, 1978 to 33¢ per share.

6. Subsequent event

In January, 1978, an extraordinary special dividend of $1.80 per common share was declared and paid. This dividend was paid out of "1971 capital surplus on hand" as that term is defined in the Income Tax Act (Canada), and accordingly was permitted by the Anti-Inflation Board over and above the maximum amounts referred to in note 5 above. Payment of this dividend was financed through regular current bank credit arrangements.

10-YEAR STATISTICAL SUMMARY

(figures in thousands except ratios, shares, and amounts per share)

FOR THE YEAR	1977	1976	1975	1974	1973	1972	1971	1970	1969	1968
Sales	$71,764	$67,089	$62,883	$58,025	$45,115	$39,294	$41,815	$41,516	$35,751	$35,662
Depreciation	399	333	290	249	179	188	202	202	215	218
Interest on bank indebtedness	773	547	466	383	132	65	88	119	141	81
Income taxes	560	880	1,270	1,330	820	640	630	550	385	570
Net income	952	928	1,234	1,195	793	675	613(b)	489	360(b)	519
% to sales	1.3%	1.4%	2.0%	2.1%	1.8%	1.7%	1.5%(b)	1.2%	1.0%(b)	1.4%
per common share (note a)	1.03	1.00	1.35	1.38	.91	.77	.69(b)	.55	.40(b)	.59
Dividends—total	306	306	336	200	128	128	128	128	128	128
Per share (note a)										
—Class A	—	—	.05	.20	.20	.20	.20	.20	.20	.20
—Common	.33	.33	.36	.22	.13	.13	.13	.13	.13	.13
Expenditures on fixed assets	449	1,671	422	469	564	88	202	89	151	492
Increase (decrease) in working capital	597	(769)	708	742	260	626	503	473	365	117
AT YEAR END										
Working capital	9,651	9,054	9,823	9,115	8,373	8,114	7,488	6,985	6,512	6,147
Shareholders' equity	14,010	13,364	12,795	11,956	10,993	10,348	9,822	9,319	8,958	8,657
Shares outstanding (note c)										
—Class A	—	—	—	17,092	17,092	17,092	17,092	17,092	17,092	17,092
—Common	926,476	926,476	926,476	143,018	143,018	143,018	143,018	143,018	143,018	143,018

Notes:

a Based on average number of shares outstanding and adjusted for capital stock reorganization and split in 1975.

b Before adding Extraordinary Items of: 1971—$25,000 or $0.03 per common share.
1969—$68,904 or $0.08 per common share.

c Capital stock was reorganized effective on June 11, 1975.

CORPORATE DIRECTORY

COCHRANE-DUNLOP LIMITED

HEAD OFFICE:
SUITE 450, NORTH TOWER
ROYAL BANK PLAZA
TORONTO, ONTARIO M5J 2J1

Directors

E. A. Bird, Toronto, Ontario
A. Gordon Cardy, Toronto, Ontario
G. R. Chater, Toronto, Ontario
F. Cochrane, Toronto, Ontario
D. Higgins, Toronto, Ontario
F. S. Martin, Ottawa, Ontario
F. F. Todd, Oakville, Ontario

Wholly-Owned Subsidiary Companies

C-D Hardware Sales Limited
Quincailleries Cochrane-Dunlop Quebec Inc.
Cochrane-Dunlop Hardware Manitoba Limited
Cochrane-Dunlop Hardware Saskatchewan Limited
Dominion Hardware Stores Limited
Cochrane-Dunlop Alberta Limited
Cochrane-Dunlop, Inc. (Buffalo, N.Y., U.S.A.)

Wholesale Branches

ONTARIO
Dryden—*264 Government Street, Dryden.*
Elliot Lake—*2 Roddis Road, Elliot Lake.*
Little Current—*Vankoughnet Street, Little Current.*
North Bay—*881 Jet Avenue, North Bay.*
Sault Ste. Marie—*550 Second Line East, Sault Ste. Marie.*
Sudbury—*122 Douglas Street W., Sudbury.*
Thunder Bay—*425 Eleventh Avenue, Thunder Bay.*
Toronto (Dealer Supply)—*1385 Bloor Street West, Toronto.*
Toronto (Industrial Supply)—*50 Woodbine Downs Boulevard, Rexdale.*
Wawa—*Government Road, Wawa.*

QUEBEC
Val d'Or—*1337 Harricana Street, Val d'Or.*

MANITOBA
Thompson—*Station Road, Thompson.*

SASKATCHEWAN
Esterhazy—*4 East Drive, Esterhazy.*
Saskatoon—*2525 Wentz Avenue, Saskatoon.*

ALBERTA
Calgary—*4215-58 Avenue S.E., Calgary.*

Retail Branches

ONTARIO

Copper Cliff	Lively	Oakville	Sudbury
Hamilton	North Bay	Sault Ste. Marie	

Officers

F. Cochrane, *President*
D. Higgins, *Executive Vice-President and General Manager*
R. L.T. Baillie, *Vice-President—Finance*

Counsel

Shibley, Righton & McCutcheon

Auditors

Clarkson, Gordon & Co.

Transfer Agent and Registrar

The Canada Trust Company—Toronto

Corp
ycoch

COCHRANE-DUNLOP LIMITED

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

	six months ended June 30 1977	1976
Funds were obtained from:		
Net income for the period	$ 385,129	$ 504,181
Depreciation, an item not requiring a current outlay of funds ..	200,000	142,200
	585,129	646,381
Funds were applied to:		
Expenditures on fixed assets	322,236	582,743
Dividends	92,648	92,647
Tax paid on undistributed income	–	16,350
	414,884	691,740
Increase (decrease) in working capital	$ 170,245	$ (45,359)
Working capital at June 30th	$9,224,149	$9,777,902

Note: Interim reports are unaudited and are subject to year end adjustment.

COCHRANE-DUNLOP
LIMITED

Interim Report for the six months ended June 30, 1977

HEAD OFFICE
160 BLOOR STREET EAST
TORONTO, ONTARIO
PHONE 416/921-3103

COCHRANE-DUNLOP LIMITED

REPORT FOR THE SIX MONTHS ENDED JUNE 30, 1977

TO THE SHAREHOLDERS:

Sales for the first half of 1977 were $35,363,000, an increase of 8% over the comparable 1976 period. Sales of the newly-opened wholesale branch in Calgary, Alberta, are developing rapidly and show promise of making a major contribution to future operating results. In general, branches associated with major industries show significant progress while some weakening in demand is noted in branches associated with the consumer market and with the construction industry. A continuation of these trends would indicate that a positive note with respect to the balance of 1977 is realistic and that, barring a major change in economic expectations in Canada, the rate of improvement in sales volumes should be maintained.

Earnings for the six months of 1977 were $385,129; a reduction from earnings of $504,181 in the prior year. Reflected in this result is full absorption of the costs of the new Calgary branch, including preliminary and continuing operating expenses, depreciation provisions, and financing costs for the facility and its equipment and for inventory which is now in place.

Dividend payments are continuing on a regular quarterly basis which represent the maximum payable under the provisions of the Anti-Inflation Act. Changes proposed in the recent federal budget were intended to permit such payments to be made out of capital surplus on hand without payment by the Company of a special tax on undistributed income. Current dividends have been paid in this manner, at the same time they continue to be received on a "tax deferred" basis in the hands of shareholders. The legislation to implement this approach is still in process through parliament.

Also arising from the last federal budget proposals is a proposed reduction in taxable income based on 3% of inventory values at the beginning of the year 1977, a recognition in part of taxes incurred on "inflation based" profits. This proposal is also in process through parliament. If implemented, it is estimated it will have a favourable affect on net income for the year of approximately $170,000. No portion of the potential tax reduction has been reflected in the interim six months' statement for 1977.

The absence of or delay in firm decisions by government on major issues, such as oil development and inflation control, tends to have unsettling effects on commercial activity. However, as indicated above, activity to date in 1977 indicates that your Company is advantageously situated to take advantage of any improvements in the Canadian economic climate.

Toronto, Canada
August 15, 1977

F. COCHRANE
President

COCHRANE-DUNLOP LIMITED

CONSOLIDATED STATEMENT OF INCOME

	six months ended June 30 1977	1976
Sales	$35,363,242	$32,752,010
Costs and expenses, exclusive of the following items	34,050,667	31,399,232
Depreciation	200,000	142,200
Interest on bank indebtedness	362,446	237,397
	34,613,113	31,778,829
Net income before income taxes	750,129	973,181
Income taxes (note b)	365,000	469,000
Net income for the period	$ 385,129	$ 504,181
Net income per common share	$ .42	$ .54

Notes: (a) Interim reports are unaudited and are subject to year end adjustment.

(b) The recent federal budget proposed a reduction in taxable income in 1977 of 3% of opening inventory values. If this proposal is confirmed in legislation, net income could be increased by approximately $170,000. No portion of this potential tax reduction has been reflected in the interim six month results in 1977.